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LIFELINE SYSTEMS INC
Form 10-Q
August 10, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended June 30, 2001

Commission File Number 0-13617

LIFELINE SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

MASSACHUSETTS
(State or other jurisdiction of
incorporation or organization)

04-2537528
(I.R.S. Employer
Identification No.)

111 Lawrence Street
Framingham, Massachusetts
(Address of principal executive offices)

01702-8156
(Zip Code)

(508) 988-1000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act:

Common stock \$0.02 par value

(Title of Class)

Indicate by check mark whether the registrant (i) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (ii) has been subject to such filing requirements for the past 90 days. Yes No

Number of shares outstanding of this issuer's class of common stock as of July 31, 2001: 6,169,795

LIFELINE SYSTEMS, INC.
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LIFELINE SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	June 2001 ---
ASSETS	(Unaud)
Current assets:	
Cash and cash equivalents	\$ 2
Accounts receivable, net	10
Inventories	2
Net investment in sales-type leases	2
Prepaid expenses and other current assets	1
Prepaid income taxes	

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Deferred income taxes	1

Total current assets	21
Property and equipment, net	29
Goodwill and other intangible assets, net	14
Net investment in sales-type leases	4
Other assets	

Total assets	\$ 71
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	\$ 1
Accrued expenses	2
Accrued payroll and payroll taxes	2
Deferred revenues	
Current portion of capital lease obligation	1
Current portion of long term debt	
Product warranty and other current liabilities	2
Accrued restructuring and other non-recurring charges	

Total current liabilities	11
Deferred income taxes	4
Deferred compensation and other non-current liabilities	
Long term portion of capital lease obligation	2
Long term debt, net of current portion	3
Accrued restructuring and other non-recurring charges, long term	1

Total liabilities	23
Commitments and contingencies	
Stockholders' equity:	
Common stock, \$.02 par value, 20,000,000 shares authorized, 6,788,350 shares issued at June 30, 2001 and 6,641,554 shares issued at December 31, 2000	
Additional paid-in capital	20
Retained earnings	31
Less: Treasury stock at cost, 621,089 shares at June 30, 2001 and December 31, 2000	(4)
Notes receivable - officer	
Accumulated other comprehensive loss/cumulative translation adjustment	

Total stockholders' equity	47

Total liabilities and stockholders' equity	\$ 71
	=====

The accompanying notes are an integral part of these consolidated financial statements.

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LIFELINE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME
(In thousands except for per share data)
(Unaudited)

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	Three months ended June 30,		
	2001	2000	2000
Revenues			
Services	\$ 16,945	\$ 13,695	\$
Net product sales	6,834	5,926	
Finance and rental income	319	352	
	-----	-----	-----
Total revenues	24,098	19,973	
	-----	-----	-----
Costs and expenses			
Cost of services	10,552	8,953	
Cost of sales	2,135	1,691	
Selling, general, and administrative	8,703	7,196	
Research and development	384	446	
Restructuring charge and other non-recurring charges	-	(15)	
	-----	-----	-----
Total costs and expenses	21,774	18,271	
	-----	-----	-----
Income from operations	2,324	1,702	
	-----	-----	-----
Other income (expense)			
Interest income	39	117	
Interest expense	(90)	(94)	
Other income	53	-	
	-----	-----	-----
Total other income (expense), net	2	23	
	-----	-----	-----
Income before income taxes	2,326	1,725	
Provision for income taxes	958	707	
	-----	-----	-----
Net income	1,368	1,018	
	-----	-----	-----
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments	80	(30)	
	-----	-----	-----
Comprehensive income	\$ 1,448	\$ 988	\$
	=====	=====	=====
Net income per weighted average share:			
Basic	\$ 0.22	\$ 0.17	\$
	=====	=====	=====
Diluted	\$ 0.21	\$ 0.16	\$
	=====	=====	=====
Weighted average shares:			
Basic	6,144	5,977	
	=====	=====	=====

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Diluted

6,486

6,196

=====

=====

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The accompanying notes are an integral part of these consolidated financial statements.

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LIFELINE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Six months ended June 30,
	----- 2001 ----
Cash flows from operating activities:	
Net income	\$ 2,486
Adjustments to reconcile net income to net cash provided by operating activities:	
Write off of fixed assets	-
Depreciation and amortization	4,382
Deferred income taxes	328
Deferred compensation	36
Changes in operating assets and liabilities:	
Accounts receivable	(1,275)
Inventories	(426)
Net investment in sales-type leases	551
Prepaid expenses, other current assets and other assets	(923)
Accrued payroll and payroll taxes	(824)
Accounts payable, accrued expenses and other liabilities	(781)
Accrued restructuring charge	(525)

Net cash provided by operating activities	3,029

Cash flows from investing activities:	
Additions to property and equipment	(5,078)
Business purchases and other	(3,323)

Net cash used in investing activities	(8,401)

Cash flows from financing activities:	
Principal payments under long term obligations	(541)
Proceeds from issuance of long term debt	2,393
Net proceeds (payments) under short-term borrowings	248
Issuance of note to officer	-
Proceeds from issuance of common stock	1,425

Net cash provided by (used in) financing activities	3,525

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Effect of foreign exchange on cash	(11)

Net increase (decrease) in cash and cash equivalents	(1,858)
Cash and cash equivalents at beginning of period	4,417

Cash and cash equivalents at end of period	\$ 2,559
	=====
Non-cash activity:	
Capital leases	\$ 1,405
Acquisition related obligation	1,495
Deferred compensation	244

The accompanying notes are an integral part of these consolidated financial statements.

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LIFELINE SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

- The information furnished has been prepared from the accounts without audit. In the opinion of the Company, the accompanying consolidated financial statements contain all adjustments necessary, consisting only of those of a normal recurring nature, to present fairly its consolidated financial position as of June 30, 2001 and the consolidated statements of income and cash flows for the three and six months ended June 30, 2001 and 2000.

While the Company believes that the disclosures presented are adequate to make the information not misleading, these statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on March 30, 2001, for the year ended December 31, 2000.

Certain amounts in the prior year have been reclassified from cost of sales to revenue to conform to the current year presentation.

The results of operations for the six-month period ended June 30, 2001 are not necessarily indicative of the results expected for the full year.

- Details of certain balance sheet captions are as follows (in thousands):

	June 30, 2001	December 31, 2000
	-----	-----
Inventories:		
Purchased parts and assemblies	\$ 271	\$ -
Work-in-process	-	-
Finished goods	1,796	1,641
	-----	-----
	\$ 2,067	\$ 1,641
	=====	=====

Property and equipment:

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Equipment	\$ 23,278	\$ 22,608
Furniture and fixtures	784	613
Equipment leased to others	14,691	11,707
Equipment under capital leases	4,940	3,535
Leasehold improvements	5,309	4,984
Capital in progress	2,086	1,230
	-----	-----
	51,088	44,677
Less: accumulated depreciation and amortization	(21,258)	(18,271)
	-----	-----
Total property and equipment, net	\$ 29,830	\$ 26,406
	=====	=====

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. The calculation of per share earnings is as follows:

(In thousands except per share figures)

	Three months ended June 30,		Six m
	2001	2000	2001
	----	----	----
Basic:			

Net income	\$1,368	\$1,018	\$2,486
Weighted average common shares outstanding	6,144	5,977	6,096
Net income per share, basic	\$ 0.22	\$ 0.17	\$ 0.41
	=====	=====	=====
Diluted:			

Net income for calculating diluted earnings per share	\$1,368	\$1,018	\$2,486
Weighted average common shares outstanding	6,144	5,977	6,096
Common stock equivalents	342	219	297
	-----	-----	-----
Total weighted average shares	6,486	6,196	6,393
Net income per share, diluted	\$ 0.21	\$ 0.16	\$ 0.39
	=====	=====	=====

For the three and six months ended June 30, 2001 options to purchase 207,160 and 284,660 shares, respectively, at an average exercise price of \$21.35 and \$20.17, respectively, have not been included in the computation of diluted net income per share as their effect would have been anti-dilutive. For the three and six months ended June 30, 2000 options to purchase 482,584 shares at an average exercise price of \$18.21 have not been included in the computation of diluted net income per share as their effect would have been anti-dilutive.

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4. SEGMENT INFORMATION

The Company is active in one business segment: designing, marketing, monitoring and supporting its personal response units. The Company maintains sales and marketing operations in both the United States and Canada.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. SEGMENT INFORMATION (continued)

Geographic Segment Data

Net sales from external customers are based on the location of the customer. Geographic information related to the results of operations for the periods ended June 30, 2001 and 2000 and the financial position as of June 30, 2001 and December 31, 2000 is presented as follows:

Dollars in thousands	Three months ended June 30,		Six months ended June 30,	
	2001	2000	2001	2000
Net Sales:				
United States	\$22,231	\$18,428	\$42,047	\$35,722
Canada	1,867	1,545	3,615	3,038
	\$24,098	\$19,973	\$45,662	\$38,760
Net Income:				
United States	\$ 1,192	\$ 879	\$ 2,174	\$ 1,676
Canada	176	139	312	265
	\$ 1,368	\$ 1,018	\$ 2,486	\$ 1,941
	June 30, 2001	December 31, 2000		
Total Assets:				
United States	\$64,483	\$58,725		
Canada	6,666	5,803		
	\$71,149	\$64,528		

5. RESTRUCTURING AND NON RECURRING CHARGES

In September 2000, the Company recorded a pre-tax non-recurring charge of approximately \$2.7 million for costs it expects to incur to address erroneous low-battery signals in some of its personal help buttons. Included in the non-recurring charge are anticipated material and mailing costs for exchanging buttons, providing hospital programs with higher inventory levels for the planned swap, and the cost of installer visits to subscriber homes to replace the buttons.

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At June 30, 2001, accrued restructuring and other non-recurring charges of approximately \$2.0 million included approximately \$27,000 of total remaining severance costs, previously disclosed, and \$2.0 million of costs associated with addressing erroneous low-battery signals in personal help buttons, as described in the preceding paragraph.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. RESTRUCTURING AND NON RECURRING CHARGES (continued)

The following is a roll-forward of accrued restructuring and non-recurring charges for the six months ended June 30, 2001:

	December 31, 2000	Amounts Utilized	June 30, 2001
Reduction of workforce and other cash flows	\$ 85	(\$58)	\$ 27
Erroneous low battery signals	2,493	(467)	2,026
Total	\$2,578	(\$525)	\$2,053

6. LONG TERM DEBT

In June 1999, the Company entered into an amended \$10.0 million line of credit which was originally obtained in April 1998. The agreement contains several covenants, including the Company maintaining certain levels of financial performance and capital structure. These financial covenants include a requirement for a current ratio of at least 1.5 to 1.0 and a leverage ratio of no more than 1.0 to 1.0. In addition, there are certain negative covenants that include limitations on the Company's capital and other expenditures, restrictions on the Company's capacity to obtain additional debt financing, restrictions on the disposition of the Company's assets, and restrictions on its investment portfolio. The line of credit matures on June 30, 2002, and as of June 30, 2001 the Company had \$4.0 million outstanding under this line.

7. GOODWILL AND INTANGIBLES

During the first six months of 2001, the Company recorded approximately \$0.7 million of intangible assets related to agreements entered into with community hospitals for conversion to services provided by the Company. The intangible assets related to these agreements consist of the cost of purchasing the rights to service and/or manage the personal response systems program located in various stand-alone facilities. These agreements allow the Company to monitor and provide other related services to existing and future subscribers over the term of the agreements. The Company amortizes the acquisition costs over the

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life of the agreements, which is typically five years

In April 2001, the Company acquired certain assets formerly owned by SOS Industries, Inc. a personal response service provider based in New Smyrna Beach, Florida with subscribers located in 37 states. The purchase price was \$3.8 million plus \$250 for every subscriber in excess of 10,000 who signed an agreement to be monitored by the Company within 90 days after the closing.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

7. GOODWILL AND INTANGIBLES (continued)

Approximately \$2.5 million of the purchase price was paid at the closing with the remainder paid within 90 days after the closing. The acquisition is being accounted for as a purchase transaction, and the resulting goodwill is being amortized over an estimated life of 10 years.

8. CHANGE IN ACCOUNTING ESTIMATE

During the second quarter of 2001, the Company analyzed the acquisitions of AlertCall, Inc. and Lutheran Social Services which were both distributors of the Company's personal response products and services, and TelCare, Inc. which provided personal response services similar to those of the Company's. As a result of this analysis, the Company revised its estimate of the useful lives of these business acquisitions from five years to ten years. The change in estimate resulted in an after-tax savings of approximately \$78,000 and an after-tax diluted earnings per share of \$0.01 for the three and six months ending June 30, 2001.

9. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations." SFAS 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. The Company does not believe that the adoption of SFAS 141 will have a significant impact on its financial statements.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets", which is effective January 1, 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill. SFAS 142 also requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company is currently assessing but has not yet determined the impact of SFAS 142 on its financial position and results of operations.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

This and other reports, proxy statements, and other communications to stockholders, as well as oral statements by the Company's officers or its

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agents, may contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, with respect to, among other things, the Company's future revenues, operating income, or earnings per share. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," and similar expressions are intended to identify forward-looking statements. There are a number of factors of which the Company is aware that may cause the Company's actual results to vary materially from those forecast or projected in any such forward-looking statement. These factors include, without limitation, those set forth below under the caption "Certain Factors That May Affect Future Results." The Company's failure to successfully address any of these factors could have a material adverse effect on the Company's future results of operations.

RESULTS OF OPERATIONS

Total revenues for the quarter ended June 30, 2001 increased nearly 21% to \$24.1 million as compared to total revenues of \$20.0 million for the quarter ended June 30, 2000. For the six months ended June 30, 2001, total revenues were \$45.7 million, 18% greater than total revenues of \$38.8 million for the same period in 2000. Total revenues include revenue generated from the assets of SOS Industries, Inc., which as previously announced, were acquired by Lifeline in April 2001, and are not expected to be accretive until next year.

Service revenues grew 24% for the three months ended June 30, 2001 to \$16.9 million from \$13.7 million for the same period in 2000. For the six months ended June 30, 2001, services revenues were \$32.8 million, an increase of 22% from \$26.8 million for the first half of 2000. Service revenues represent nearly 72% of the Company's year to date total revenues as compared to 69% of total revenues for the first six months of 2000. This growth is a result of a variety of factors. The Company is continuing its service offering strategy and achieved a 14% increase in its monitored subscriber base to approximately 332,000 subscribers as of June 30, 2001 from 292,000 subscribers monitored at June 30, 2000. The Company also introduced a price increase for its monitoring services in 2001 which resulted in a higher average revenue per subscriber in the first half of 2001 as compared to the same period in 2000. The increase in service revenues and subscribers is also due in part to the acquisition of the assets of SOS Industries, Inc., as mentioned above. The Company's ability to sustain the current level of service revenue growth depends on its ability to continue to make improvements in service delivery, expand the market for its personal response services, convert community hospital programs to services provided by the Company and increase its focus on referral development and innovative partner relationships in new channels of distribution. The Company believes that the high quality of its services and its commitment to providing caring and rapid response to the at-risk elderly and the physically challenged will be factors in meeting this challenge.

Net product revenues for the second quarter of 2001 increased 15% over the second quarter of 2000 to \$6.8 million from \$5.9 million. For the six months ended June 30, 2001, net product revenues were \$12.2 million, an increase of nearly 9% from \$11.2 million for the same period in 2000. During the second quarter of 2001, the Company launched a newly developed site-monitoring platform for those customers who perform their own monitoring. The majority of the increase in

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product revenue during the second quarter is a result of sales of this new platform. The Company expects that product sales will be favorably impacted for the remainder of 2001 as sales of this new platform is expected to continue. However, the Company continues to believe that equipment sales will remain flat or decline in future periods as it has historically experienced little or no

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growth in sales of its product since the Company began packaging products and services into a single service offering.

Finance and rental income, representing revenue earned from the Company's portfolio of sales-type leases, decreased approximately 9% in the second quarter of 2001 to \$319,000, from \$352,000 for the second quarter of 2000. For the six months ended June 30, 2001, finance and rental income declined approximately 3% to \$692,000 from \$713,000 for the same period in 2000. With the Company's focus on its service business segment it expects finance income to decline in future periods because leasing is directly related to its product business.

Total recurring revenues, consisting of service revenues and finance and rental income, increased 23% for the three months ended June 30, 2001 to \$17.3 million from \$14.0 million for the same period in 2000. For the six months ended June 30, 2001, total recurring revenues increased 22% to \$33.4 million from \$27.5 million for the first half of 2000. These increases reflect the continued expansion of the Company's service business segment with its focus on increasing the Company's recurring revenue base coupled with recurring revenues generated from the acquisition of SOS Industries, Inc.

Cost of services increased to \$20.1 million for the six months ended June 30, 2001 from \$17.7 million for the comparable prior period as a result of a variety of factors. The Company incurred higher amortization of goodwill along with associated operational costs in the first half of 2001 as a result of the purchase of SOS Industries, Inc. in April 2001 and the purchase of Argus Emergency Medical Division in the third quarter of 2000. The Company also had higher amortization of intangible acquisition costs incurred pursuant to agreements entered into with community hospitals for conversion to services provided by the Company. However, cost of services, as a percentage of service revenues, significantly improved to 62% and 61% for the three and six months ended June 30, 2001 as compared to 65% and 66% for the same periods in 2000 and is aligned with the Company's goal of making its service offerings more profitable. The Company expects a positive improvement in its fiscal 2001 service margin as compared to its fiscal 2000 service margin.

Cost of sales was 31% and 33% of net product sales for the three and six months ended June 30, 2001, respectively, as compared to 29% and 30% for the three and six months ended June 30, 2000. Cost of sales was higher as a percentage of net product sales than the comparable periods in 2000 due in part to sales of the Company's new site monitored platform which maintains a cost that is higher than the cost of the Company's home communicators. The Company also experienced an increase in sales of its lower margin marketing accessories as compared to the same periods in 2000 as its customers are marketing and growing their Lifeline service. The Company expects a slight increase in cost of sales as a percentage of net product sales for the remainder of 2001.

Selling, general and administrative ("SG&A") expenses, as a percentage of total revenues, were 36% for the three and six months ended June 30, 2001 as compared to 36% and 35% during the second quarter and six months ended June 30, 2000. For the six months ended June 30, 2001, SG&A expenses increased \$2.9 million to \$16.6 million from \$13.7 for the six months ended June 30, 2000. The Company's increased expenditures are primarily attributable to sales and marketing initiatives in

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the first half of 2001 that the Company did not incur during the first half of 2000. Increased information technology personnel and consultants in the first half of 2001 as compared to the same period in 2000 also contributed to the increased SG&A expenses. The Company expects an increase in SG&A expenses during 2001 as it continues with its sales, marketing and business initiatives, but

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believes that these expenses will be approximately consistent with 2000 as a percentage of total revenues.

Research and development expenses remained consistent at approximately 2% of total revenues for the three and six months ended June 30, 2001 and 2000. Research and development efforts are focused on ongoing product improvements and developments. The Company expects to maintain these expenses at a consistent percentage of total revenues for the remainder of 2001.

The Company's effective tax rate was 41% for the six months ended June 30, 2001 and 2000.

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations." SFAS 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. The Company does not believe that the adoption of SFAS 141 will have a significant impact on its financial statements.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets", which is effective January 1, 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill. SFAS 142 also requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company is currently assessing but has not yet determined the impact of SFAS 142 on its financial position and results of operations.

LIQUIDITY AND CAPITAL RESOURCES

During the six months ended June 30, 2001, the Company's portfolio of cash and cash equivalents decreased by more than \$1.8 million to \$2.6 million at June 30, 2001 from \$4.4 million at December 31, 2000. The decrease in cash was mainly attributable to payments of approximately \$2.3 million in employee bonuses, a net increase in the Company's accounts receivable portfolio of approximately \$1.3 million as a result of the 18% increase in revenue, and purchases of property and equipment amounting to \$5.1 million. The use of cash to finance the purchase price of the assets of SOS Industries, Inc. in April 2001 was offset, in part by borrowings of nearly \$2.4 million. The Company also paid approximately \$0.5 million to community hospitals for conversions to services provided by the Company. This represented the cost of purchasing the rights to service and/or manage the personal response systems program previously operated by the local community hospitals. Profitable operations of \$7.2 million helped to offset these expenditures.

The Company is party to Master Lease Agreements for up to \$5.6 million for furniture, computers, security systems and other related equipment purchases. For financial reporting purposes, these

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leases are recorded as capital leases and accordingly the associated assets are being depreciated over their estimated useful life. As of June 30, 2001 the Company had made purchases of approximately \$4.3 million under these agreements.

In June 1999, the Company entered into an amended \$10.0 million line of credit

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which was originally obtained in April 1998. The agreement has two components, the first of which is a working capital line of credit, the other, the ability to convert up to five million dollars into a five-year fixed loan. The working capital line of credit's interest rate is based on the London Interbank Offered Rate (LIBOR), while the fixed loan is at the bank's prime interest rate. The agreement contains several covenants, including the Company maintaining certain levels of financial performance and capital structure. These financial covenants include a requirement for a current ratio of at least 1.5 to 1.0 and a leverage ratio of no more than 1.0 to 1.0. In addition, there are certain negative covenants that include limitations on the Company's capital and other expenditures, restrictions on the Company's capacity to obtain additional debt financing, restrictions on the disposition of the Company's assets, and restrictions on its investment portfolio. This line of credit matures on June 30, 2002, and as of June 30, 2001 the Company had \$4.0 million outstanding under this line.

The Company expects that funding requirements for operations and in support of future growth are expected to be met primarily from operating cash flow, existing cash and marketable securities and its \$10.0 million line of credit. The Company expects these sources will be sufficient to finance the cash needs of the Company through the next twelve months. This includes the continued investment in its response center platform, the requirements of its internally funded lease financing program, the second quarter acquisition of certain assets formerly owned by SOS Industries, Inc., any future potential acquisitions and other investments in support of its current business.

CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this Quarterly Report on Form 10-Q and presented elsewhere by management from time to time.

The Company completed the transition of its United States subscribers to its new CareSystem call center platform during 1999. There can be no assurance that the Company will realize the intended benefits from the new system.

The Company recorded a non-recurring charge of approximately \$2.7 million in the third quarter of 2000 for costs it expects to incur to address a previously disclosed battery-related issue, including anticipated material and mailing costs for exchanging buttons, providing hospital programs with higher inventory levels for the planned swap, and support for the cost of installer visits to subscriber homes to replace the button. The Company cannot be certain that the charge it recorded to address this issue will be sufficient to cover all of its associated expenses. In addition, the Company has changed its battery vendor. The Company cannot be certain that it will not experience disruption related to such change.

During the third quarter of 1999, the Company completed the outsourcing of the manufacturing of its personal response equipment to the Ademco Group, a division of Honeywell International, Inc. This

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decision represented a change in the Company's manufacturing strategy, as it no longer supports a manufacturing site at its corporate location. There can be no assurance that the Company will realize the intended cost savings it anticipates, or that it will not experience delays in obtaining products from Ademco as a result of process difficulties, component shortages or for other reasons. Any such delay could have a material adverse effect on the Company's

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business, financial condition, or results of operations.

The Company's results are partially dependent on its ability to develop services and products that keep pace with continuing technological changes, evolving industry standards, changing subscriber preferences and new service and product introductions by the Company's competitors. There can be no assurance that services, products or technologies developed by others will not render Lifeline's services or products noncompetitive or obsolete.

The Company's revenue growth is dependent on its ability to increase the number of subscribers served by its monitoring centers while continuing to sell its product to its healthcare programs. The Company's ability to continue to increase service revenue is a key factor in its long-term growth, and there can be no assurance that the Company will be able to do so. The Company's failure to increase service and product revenue could have a material adverse effect on the Company's business, financial condition, or results of operations.

The Company's monitoring operations are concentrated principally in its corporate headquarters facility. Although the Company believes that it has constructed safeguards to protect against system failures, the disruption of service at its monitoring facility, whether due to telephone or electrical failures, earthquakes, fire, weather or other similar events or for any other reason, could have a material adverse effect on the Company's business, financial condition, or results of operations.

The Company believes that its future success will depend in large part upon its ability to attract and retain key personnel, especially in its information technology department. Although the Company believes it is making progress in retaining and recruiting well-trained, highly capable people despite a very competitive employment market, there can be no assurance that the Company will continue to be successful in attracting and retaining such personnel.

While the Company's product revenue has increased during the first half of 2001 as compared to the first half of 2000, product revenue is anticipated to remain flat as a result of the Company's strategy of combining service and hardware offerings to support the transition to a service oriented business. As the Company continues growing its service business segment to increase its recurring revenue, there can be no assurance that service revenue will increase at a rate sufficient to offset the expected decrease in higher margin product revenue both on a quarterly and annual basis. Moreover, the Company's product sales are ordinarily made to healthcare providers that establish their own Lifeline programs. These healthcare providers typically rent, rather than sell, the Lifeline products to subscribers and accordingly following such time as a product is no longer used by a subscriber, it is returned to the healthcare provider and becomes available for rent to another subscriber. As a result of this use and reuse of the Company's products, sales of such products are dependent on growth in the number of subscribers and on the ability of the Company to encourage its healthcare provider customers to replace their existing inventory by continuing to enhance its products with new features or new technology.

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The Company may expand its operations through the acquisition of additional businesses, such as its recent acquisition of certain assets formerly owned by SOS Industries, Inc. in April 2001. There can be no assurance that the Company will be able to identify, acquire or profitably manage additional businesses or successfully integrate any acquired businesses into the Company without substantial expenses, delays or other operational or financial problems. In addition, acquisitions may involve a number of special risks, including diversion of management's attention, failure to retain key acquired personnel,

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unanticipated events, contingent liabilities and amortization of acquired intangible assets. There can be no assurance that the acquired businesses, if any, will achieve anticipated revenues or earnings.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has considered the provisions of Financial Reporting Release No. 48 "Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments, and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments." The Company had no holdings of derivative financial or commodity-based instruments or other market risk sensitive instruments entered into for trading purposes at June 30, 2001. As described in the following paragraphs, the Company believes that it currently has no material exposure to interest rate and foreign currency exchange rate risks in its instruments entered into for other than trading purposes.

Interest rates

The Company's balance sheet includes a revolving credit facility and a term loan that are subject to interest rate risk. Both loans are priced at floating rates of interest, with a base of LIBOR or prime rate at the Company's option. As a result of these factors, at any given time, a change in interest rates could result in either an increase or decrease in the Company's interest expense. The Company performed a sensitivity analysis as of June 30, 2001 to assess the potential effect of a 100 basis point increase or decrease in interest rates and concluded that short-term changes in interest rates should not materially affect the Company's consolidated financial position, results of operations or cash flows.

Foreign currency exchange rates

The Company's earnings are affected by fluctuations in the value of the U.S. Dollar as compared to the Canadian Dollar, as a result of the sale of its products and services in Canada and translation adjustments associated with the conversion of the Company's Canadian subsidiary into the reporting currency (U.S. Dollar). As such, the Company's exposure to changes in Canadian exchange rates could impact the Company's consolidated financial position, results of operations or cash flows. The Company performed a sensitivity analysis as of June 30, 2001 to assess the potential effect of a 10% increase or decrease in Canadian foreign exchange rates and concluded that short-term changes in Canadian exchange rates should not materially affect the Company's consolidated financial position, results of operations or cash flows. The Company's sensitivity analysis of the effects of changes in foreign currency exchange rates did not factor in a potential change in sales levels or local prices for its services/products.

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PART II. OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of Stockholders of the Company was held on May 16, 2001. The stockholders of the Company elected members of the Board of Directors and ratified the selection of PricewaterhouseCoopers LLP as the Company's accountants for 2001.

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NUMBER OF SHARES OF COMMON STOCK

	FOR ---	AGAINST -----	ABSTAINED -----	BROKER NON- VOTES -----
Carolyn C. Roberts	4,575,742	-	43,871	-
Gordon C. Vineyard, M.D.	4,589,006	-	30,607	-
Ratification of appointment of PricewaterhouseCoopers LLP	4,604,732	10,631	4,250	-

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Reports on Form 8-K - No reports on Form 8-K were filed for the three months ended June 30, 2001.

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LIFELINE SYSTEMS, INC.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

August 10, 2001	LIFELINE SYSTEMS, INC.
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Date	Registrant

/s/ Ronald Feinstein

Ronald Feinstein
Chief Executive Officer

/s/ Dennis M. Hurley

Dennis M. Hurley
Senior Vice President of Finance and
Administration, Principal Financial
and Accounting Officer

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